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Directive 86-24: Lottery Winnings; Lottery Tickets

Facts: Taxpayer Davis, a computer programmer, buys 15 lottery tickets each week choosing ticket numbers according to a system she has developed. During the current taxable year, Davis spent \$390 on these tickets. For the same period she picked one lucky number and had lottery winnings of \$300. She includes the \$300 in income on her U.S. Form 1040 and deducts \$300 of the \$390 spent on lottery tickets on her U.S. Schedule A.

Issue 1: Must Davis include her lottery winnings in her Massachusetts gross income?

Issue 2: May Davis deduct the cost of her lottery tickets on her Massachusetts return?

Discussion: Federal gross income is all income from whatever source derived, including gains from gambling. I.R.C. § 61. Massachusetts gross income is federal gross income with certain modifications of no relevance here. G.L. c. 62, § 2(a). Thus, Massachusetts taxpayers must include lottery winnings in Massachusetts gross income.

Massachusetts gross income is divided into two classes, Part A income taxed at 10% and Part B income taxed at 5%. Part A income is comprised of interest, dividends, and net capital gain, other than interest and dividends from savings deposits in Massachusetts banks. G.L. c. 62, § 2(b)(1). Part B income is all other income subject to taxation. G.L. c. 62, § 2(b)(2). Consequently, gambling gains are Part B income, taxed at 5%.

Massachusetts law adopts the deductions permitted under section 62 of the Internal Revenue Code, with certain modifications. G.L. c. 62, § 2(d). The deductions allowed under section 62 of the Code include the deductions permitted under sections 161 to 196, provided they are attributable to a trade or business. I.R.C. § 62(1). Section 165 allows a deduction for losses from wagering transactions to the extent of wagering gains. I.R.C. § 165(d). Thus, a Massachusetts taxpayer may deduct wagering losses to the extent of winnings, but only if the wagering activities of the taxpayer constitute a trade or business.

Taking part in a lottery does not constitute a trade or business even when the taxpayer does so on a continuous basis, where the taxpayer does not hold himself or her self out as providing goods or services to the public. See *Forte Investment Fund v. State Tax Commission*, 369 Mass. 786 (1976), affirming *Forte Investment Fund v. State Tax Commission*, Appellate Tax Board, Docket No. 64558, June 6, 1975. Therefore, Taxpayer Davis may not deduct the cost of the losing lottery tickets on her Massachusetts return. However, since federal law taxes the *gain* from gambling, Taxpayer Davis may reduce her winnings by the amount paid for the winning ticket.

Directive 1: Taxpayer Davis must include her lottery winnings (reduced by the cost of her winning ticket) in her Massachusetts gross income. The winnings constitute Part B income, taxed at 5%.

Directive 2: She cannot deduct the cost of the losing tickets to the extent of gambling gains because these costs are not incurred in a trade or business.

Reference: G.L. c. 62, § 2(a), (b), (d); I.R.C. §§ 61, 62, 165(d). *Forte Investment Fund v. State Tax Commission*, 369 Mass. 786 (1976).

/s/Ira A. Jackson
Ira A. Jackson
Commissioner of Revenue

31 December 1986

DOR-D 86-24

This Directive represents the official position of the Department of Revenue on the application of the law to the facts as stated. The Department and its personnel will follow this Directive, and taxpayers may rely upon it, unless it is revoked or modified pursuant to 830 CMR § 62C.01(5)(e). In applying this Directive, however, the effect of subsequent legislation, regulations, court decisions, Directives, and TIRs must be considered, and Department personnel and taxpayers may rely upon this Directive only if the facts, circumstances and issues presented in other cases are substantially the same as those set forth in this Directive.